COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2110-01
Bill No.: HB 915
Subject: Fees; Attorneys; Courts; Labor and Industrial Relations Department
Type: Original
Date: April 15, 2013

Bill Summary: This proposal establishes the Employee Reclassification Act creating provisions for DOLIR to define independent contractor and the procedures by which DOLIR may change an individual's classification to an employee.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
General Revenue	$0 to (Unknown)	$0 to (Unknown)	$0 to (Unknown)
Total Estimated Net Effect on General Revenue Fund	**$0 to (Unknown)**	**$0 to (Unknown)**	**$0 to (Unknown)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 11 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Unemployment Compensation Trust	$0 to (Unknown)	$0 to (Unknown)	$0 to (Unknown)
Unemployment Compensation Administration	($46,000,000)	($46,000,000)	($46,000,000)
Wagner-Peyser	($13,000,000)	($13,000,000)	($13,000,000)
Total Estimated Net Effect on All Federal Funds	**(Unknown greater than $59,000,000)**	**(Unknown greater than $59,000,000)**	**(Unknown greater than $59,000,000)**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☐ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Local Government	**$0**	**$0**	**$0**

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FISCAL ANALYSIS

ASSUMPTION

Officials at the **Department of Labor and Industrial Relations** (**DOLIR**) assume this proposal creates the "Employee Reclassification Act." The United States Department of Labor (USDOL) has informally reviewed this bill and has determined that this bill raises several conformity issues with federal law.

The federal government and state governments are jointly responsible for administering the unemployment insurance (UI) system. State laws must meet certain federal requirements for the state agency to receive the administrative grants needed to operate its UI program and for employers to qualify for certain tax credits.

Non-conformity with federal law could jeopardize the certification of Missouri's UI program. If the program fails to be certified, Missouri would lose approximately $46 million in federal funds the state receives each year to administer the UI program. Additionally, Missouri would lose the approximately $13 million in federal funds each year the Department of Economic Development-Division of Workforce Development uses for Wagner-Peyser reemployment services.

The Federal Unemployment Tax Act (FUTA) imposes a 6.0% payroll tax on employers. Most employers never actually pay the total 6.0% due to credits they receive for the payment of state unemployment taxes and for paying reduced rates under an approved experience rating plan. FUTA allows employers tax credits up to a maximum of 5.4% against the FUTA payroll tax if the state UI law is approved by the Secretary of Labor. However, if this bill causes Missouri's program to be out of compliance or out of conformity, Missouri employers would pay the full 6.0%, or approximately an additional $859 million per year.

This bill raises several issues with federal law. First, subsection 285.080.3, provides that any funds paid to the individuals or entities shall be legally presumed, absent conclusive evidence to the contrary, to be a payment for service as an independent contractor and not for employment. Federal law does not permit these services to be presumed as independent contractor services when they are performed in an employer - employee relationship for governmental entities, Indian Tribes, or certain nonprofit entities. As a result, the bill raises a conformity issue.

Section 3304(a)(6)(A), FUTA requires, as a condition of certification of the unemployment compensation (UC) program that UC be payable based on certain services that are not subject to the FUTA tax. Services performed for state and local governmental entities and Indian Tribes (Section 3306(c)(7), FUTA) and certain nonprofit organizations (Section 3306(c)(8), FUTA) must be covered under the UC system if an employer/employee relationship exists.

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ASSUMPTION (continued)

Section 3306(i), FUTA, references the definition of an employee in Section 3121(d) of the Internal Revenue Code (IRC) of 1986. Section 3121(d) (2), IRC, specifies that employee means "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." Regulations implementing Section 3306(i), FUTA, are found at 26 C.F.R. 31.3306(i)-1. These regulations specify that an individual is an employee if the relationship between the individual and the person for whom services are performed has the legal relationship of employer and employee.

The regulations go on to point out that "it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if [the employer] has the right to do so." Concerning independent contractors, the regulations are not permissive. If an employer-employee relationship exists, "it is of no consequence that the employee is designated as a partner, co-adventurer, agent, independent contractor, or the like." The basic determinant of whether or not service is performed by an independent contractor is the right of direction and control, whether or not it is exercised. Thus, whether an individual is an "employee" must be determined under a state law test at least as stringent as the Federal common law test of direction and control.

Second, placing the burden of proving UI coverage on an individual is not an acceptable method of administration for ensuring full payment of UI when due. Section 303(a) (1) of the Social Security Act (SSA) requires, as a condition of receiving administrative grants for the UI program, that state law include provision for:

> "(1) Such methods of administration . . . as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due."

In the case of the rebuttable presumption provision, an individual would have to successfully overcome the presumption of independent contractor status. The USDOL indicates that this is not an acceptable method of administration for ensuring full payment of UI when due. Further, the burden for assuring the coverage requirements of Section 3304(a) (6) (A), (FUTA) is transferred from the State to the individual. The USDOL does not believe this is an acceptable method of administration.

Third, subsection 285.080.9 raises a similar issue with federal law. This subsection provides that any pending investigation as to whether services were performed in an employment relationship would be cancelled pending DOLIR adopting a rule on employee status following rule-making procedures. A determination of whether services are covered affects both whether an individual has earned sufficient wage credits to monetarily qualify for UC and whether an employer is liable

ASSUMPTION (continued)

to UC taxes. This suspension of an individual's right to determine his or her monetary qualification for benefits raises an issue with the "when due" requirements of Federal UC law. As noted above, Section 303(a)(1), SSA, requires, methods of administration reasonably calculated to insure full payment of unemployment compensation when due.

Fourth, subsection 285.080.6, requires that the Department afford employers the same relief afforded to employers under Section 530 of the IRC of 1986, as amended. This reference to the Section 530 of the IRC is to the "safe harbor" provision. However, the safe harbor provision is solely a tax relief provision. It does not amend the definition of "employee" under Section 3306(i), FUTA, which determines the scope of the mandatory coverage requirement of Section 3304(a)(6)(A), FUTA, for purposes of determining an employer-employee relationship. Internal Revenue Service Revenue Procedure 85-18, published on April 1, 1985, clearly states that the safe harbor provision does not change the status of these workers from employees to self-employed. Therefore, if Missouri should offer the same relief as provided in Section 530, it would not permit Missouri to deny UC coverage based on services provided for governmental or nonprofit entities or federally-recognized Indian tribes.

Section 3303(a)(1), FUTA, requires, as a condition for employers in a state to receive the additional credit against the federal tax, that state law provide that:

> "no reduced rate of contributions to a pooled fund is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk . . ."

If the application of the safe harbor provision would be to relieve employers of liability for state UC taxes even though services are required to be covered under the state UC law, this would "forgive" the back taxes of employers where there was coverage. If the issue is "forgiving" taxes otherwise due, then an issue would be raised with the experience rating since the forgiveness of taxes otherwise due results in the assignment of a zero tax rate on those services, which has the result of providing a reduced rate of tax on a basis not related to the experience of the employer.

Fifth, subsection 285.080.10, requires that the fees and expenses be paid from the UC administrative grant, it will raise an issue with federal law. Section 303(a)(8) of the Social Security Act limits the expenditure of UC grant funds to amounts necessary for "the proper and efficient administration" of the State's UC law. Fees for an employer's attorney for litigation are not considered a necessary expense for the "proper and efficient administration" of the State's UC law; therefore, they are not allowable expenditures from the State's UC grant.

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ASSUMPTION (continued)

If this bill requires that the fees and expenses be paid from the state unemployment trust fund, it will raise an issue with federal law. Section 3304(a)(4), FUTA, requires, as a condition for employers in a state to receive credit against the Federal tax, that state law provide that:

> "All money withdrawn from the unemployment fund of the State shall be used solely in the payment of unemployment compensation, exclusive of expenses of administration, and for refunds of sums erroneously paid into such fund…"

Section 303(a)(5), SSA, provides a similar requirement as a condition for a state to receive administrative grants. These provisions, known as the "withdrawal standard," mean that money may only be withdrawn from the unemployment fund for payment of UC and to refund money paid into the fund in error.

In addition to these conformity issues, this bill would also pose several administrative challenges to DOLIR. First, DOLIR currently does not have a process for the creation of opinion letters. This bill would require DOLIR to conduct an investigation prior to providing an opinion letter to an employer. It is unclear how this process would work when a business requests an 'opinion' prior to actually bringing on workers.

Second, this bill does not provide for situations in which the relationship has changed since the opinion letter was issued. Thus, under this bill, the Department could issue an opinion letter based upon application of the law at that time and determine employment at a later date based upon a new investigation/audit. In this situation, the Department would be obligated to forgive any additional tax, interest, etc. owed as a result of mis-classification.

Third, if the Department is required to produce opinion letters and to mail notice to every employer registered with the Department and the Department of Revenue regarding the new rule, the workload of the Department will dramatically increase beyond current resources in order to perform such investigations that will be necessary prior to issuing an opinion letter.

Fourth, this requires that interest and fine accrual be tolled if the determination is appealed for the period that the issue is under appeal. Under current law, a determination is considered legally binding until such time that it is amended or reversed. Employers continue to be billed in accordance with the determination that is in place and are expected to report in accordance with the determination. This change will require significant computer programming to implement.

ASSUMPTION (continued)

Officials at the **City of Columbia**, **Department of Conservation**, **Joint Committee on Administrative Rules**, **Linn State Technical College**, **Missouri Department of Transportation**, **Missouri State University**, **Metropolitan Community College**, **Northwest Missouri State University**, **Office of Administration - Division of Personnel**, **Parkway School District**, **St. Louis County**, **University of Central Missouri** and the **University of Missouri** each assume there is no fiscal impact to their organization from this proposal.

Officials at the **Office of Attorney General** assume that any potential costs arising from this proposal can be absorbed with existing resources.

Officials from the **Office of the Secretary of State (SOS)** state many bills considered by the General Assembly include provisions allowing or requiring agencies to submit rules and regulations to implement the act. The SOS is provided with core funding to handle a certain amount of normal activity resulting from each year's legislative session. The fiscal impact for this fiscal note to the SOS for Administrative Rules is less than $2,500. The SOS recognizes that this is a small amount and does not expect that additional funding would be required to meet these costs. However, the SOS also recognizes that many such bills may be passed by the General Assembly in a given year and that collectively the costs may be in excess of what the office can sustain with the core budget. Therefore, the SOS reserves the right to request funding for the cost of supporting administrative rules requirements should the need arise based on a review of the finally approved bills signed by the governor.

Oversight assumes the SOS could absorb the costs of printing and distributing regulations related to this proposal. If multiple bills pass which require the printing and distribution of regulations at substantial costs, the SOS could request funding through the appropriation process.

FISCAL IMPACT - State Government	FY 2014 (10 Mo.)	FY 2015	FY 2016
GENERAL REVENUE			
Cost - Department of Labor and Industrial Relations - administrative costs	$0 to (Unknown)	$0 to (Unknown)	$0 to (Unknown)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0 to (Unknown)**	**$0 to (Unknown)**	**$0 to (Unknown)**
UNEMPLOYMENT COMPENSATION TRUST FUND			
Cost - Department of Labor and Industrial Relations - administrative costs	$0 to (Unknown)	$0 to (Unknown)	$0 to (Unknown)
ESTIMATED NET EFFECT ON UNEMPLOYMENT COMPENSATION TRUST FUND	**$0 to (Unknown)**	**$0 to (Unknown)**	**$0 to (Unknown)**
UNEMPLOYMENT ADMINISTRATION FUND			
Loss- Federal Funds	($46,000,000)	($46,000,000)	($46,000,000)
ESTIMATED NET EFFECT ON UNEMPLOYMENT COMPENSATION ADMINISTRATION FUND	**($46,000,000)**	**($46,000,000)**	**($46,000,000)**
WAGNER-PEYSER FUND			
Loss - Federal Funds	($13,000,000)	($13,000,000)	($13,000,000)
ESTIMATED NET EFFECT ON WAGNER-PEYSER FUND	**($13,000,000)**	**($13,000,000)**	**($13,000,000)**

FISCAL IMPACT - Local Government	FY 2014 (10 Mo.)	FY 2015	FY 2016
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses could be impacted by the FUTA rate.

FISCAL DESCRIPTION

This bill establishes the Employee Reclassification Act. In its main provisions, the bill:

(1) Requires the Department of Labor and Industrial Relations to provide a clear and concise rule for defining "independent contractor" and a procedure for changing an individual's classification from an independent contractor to an employee;

(2) Specifies that for purposes of the workers compensation, unemployment compensation, and tax withholding laws, payments made to an entity organized under Chapter 347, RSMo, certain state or locally licensed service providers, or to a licensed attorney will be presumed to be made to an independent contractor and not to an employee;

(3) Authorizes individuals and employers to request an opinion letter from the department on the classification of a particular person as an independent contractor or an employee. An employer classifying someone as an independent contractor based on the department's opinion letter cannot be fined if the department subsequently determines that the person is an employee;

(4) Gives an employer 60 days to comply with the reclassification of an employee after the department audits the employer, and the employer, in the absence of fraud, will not be liable for any taxes, interest, or fines for the mis-classification;

(5) Requires the department to offer the same relief to Missouri employers as afforded to employers under Section 530 of the Internal Revenue Code of 1986, as amended;

(6) Allows an employer to appeal the department's audit findings, and the fine and assessment of interest levied against an employer for employee mis-classification as an independent contractor will be tolled during the appeal, absent fraud on the part of the employer;

FISCAL DESCRIPTION (continued)

(7) Requires the department to take public comments before issuing the final rule and requires a copy of the final rule to be mailed to every employer registered with the department and the Department of Revenue;

(8) Requires all pending investigations of employee mis-classification, including those in the appellate courts, to be terminated permanently upon the effective date of the bill. The department's definition of employee mis-classification must be provided to employers after the public comment period ends, and all employers will be given 180 days to comply; and

(9) Awards reasonable costs and fees, including attorney fees, if an employer successfully appeals the reclassification of an employee to an independent contractor.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

City of Columbia
Department of Conservation
Department of Labor and Industrial Relations
Joint Committee on Administrative Rules
Linn State Technical College
Missouri Department of Transportation
Missouri State University
Metropolitan Community College
Northwest Missouri State University
Office of Administration
  Division of Personnel
Office of Attorney General
Office of the Secretary of State
Parkway School District
St. Louis County
University of Central Missouri
University of Missouri

Ross Strope
Acting Director
April 15, 2013

JH:LR:OD